In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 473

JOHN H. BINGLER, DISTRICT DIRECTOR OF INTERNAL REVENUE, PETITIONER

v.

RICHARD E. JOHNSON, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR PETITIONER

1. The essential thesis of respondents' case is that all monies paid for the support of a degree candidate constitute a "scholarship" and therefore should be excludable from income under Section 117 of the Internal Revenue Code of 1954 unless expressly includible under Section 117(b)(1). (See Br. 11–14.) Yet no authority—indeed not even the Third Circuit in this case—has accepted this interpretation of the statute. Thus the opinion below states (R. 127):

> A significant commitment by the student in return for a grant would, of course, place that grant outside the category "scholarship", at least to the extent of the value of that commitment. * * *

334-826—69

Respondents, in attempting to distinguish *Reese* v. *Commissioner*, 373 F. 2d 742 (C.A. 4), affirming *per curiam* 45 T. C. 407, and *Woddail* v. *Commissioner*, 321 F. 2d 721 (C.A. 10), make an equivalent concession. In asserting that those decisions are not in conflict with the Third Circuit's here, and are not pertinent to the instant problem, they argue that (Br. 17) "the amount paid [Miss Reese] was not a scholarship * * *. Rather, the amount was paid for the *services actually rendered* by the taxpayer as a teacher" (emphasis supplied). And *Woddail* is distinguished on the ground that the taxpayer (Br. 18) "was not a degree candidate at an educational institution and *actually rendered services* that were of direct benefit to his grantor" (emphasis supplied).[1] Thus, in speaking of services "actually ren-

[1] Respondents' contentions regarding congressional intent (Br. 11–13) are premised on the claim (Br. 11) that the word "scholarship" refers to a grant to a degree candidate while "fellowship" refers to a grant "to an individual who is not a candidate for a degree * * *." The common understanding, however, is different. To the extent that there is a distinction between the terms, the phrase "scholarship" describes grants to an undergraduate student while the word "fellowship" refers only to grants to a graduate student. The bulletin of the Massachusetts Institute of Technology (July 1968) states (p. 82): "A fellowship * * * is a grant to a graduate student which covers his tuition and provides, in addition, a stipend to help defray his living expenses. In the context of the Graduate School, a scholarship is a grant which only covers, or helps to defray, tuition only." It is the general understanding of grantors that the word "fellowship" describes grants to graduate students seeking a degree. See, *e.g.*, National Industrial Conference Board Publication, No. 209, Combating Knowledge Obsolescence: I. Company Fellowship Plans (1968) p. 3; Johns Hopkins Graduate Programs 1968 and 1969, p. 206; Stanford University Bulletin, Series 19, No. 1 (Jan. 2, 1968) p. 54; Graduate School Bulletin of Yale University, Series 63, No. 14, (15 July 1967) pp. 20–21.

dered," respondents mean that there is no scholarship or fellowship if services are performed at the same time as funds are received.

Respondents never explain why Miss Reese's and Dr. Woddail's grants are taxable income but theirs are excludable scholarships. That the former two provided present services, and respondents promised future services as a condition of their grants from Westinghouse, is not a valid distinction. It has long been established that, for purposes of income taxation, it matters not that money is paid in return for services past or services to be rendered in the future. The result must be the same as when services are rendered at the same time as the compensation is received. Nothing in the statute or in the legislative history would exempt respondents' grants as scholarships, while taxing Miss Reese's and Dr. Woddail's as salary.

If the Third Circuit's approach is appropriate, then how is it to be determined whether a commitment is "significant" enough to fall beyond the meaning of the words "scholarship" and "fellowship"? The Third Circuit said that this would occur (R. 127) "if the grantee had to barter for his stipend, giving full value for it * * *." But when would there be a "barter" if not here? If respondents did not give full enough "value" in their promises to return to the Bettis Laboratory for one or two years after completing their doctoral dissertations, when would value be adequate? There are, we suggest, no better measures of a grantee's commitment and its value than this record shows. The Bettis doctoral program was

intended to induce people to come to work for Westinghouse; as two of the respondents expressly conceded, that is exactly what happened (R. 22, 35). The AEC, Westinghouse, and the respondents each considered the promises to return to Bettis for a minimum time an adequate consideration for the grants. Westinghouse needed trains engineers and scientists, and this was an effective way to get them, as the facts of this case show.

Surely, it cannot be said as a matter of law that respondents' commitments were not "significant" enough or that they failed to barter for a full enough "value". At the very least, the significance and value of their commitments and of the paid leave Westinghouse and the AEC allowed them was a matter for the finder of fact to decide.

2. Respondents' argument also misconceives the legislative history. Of course, it is true that Congress wanted to do away with a need to determine on a case by case basis whether a gift was intended. But nothing Congress said sustains respondents' assertion (Br. 10) that Congress therefore intended no inquiry into the existence of salary or other compensation. The legislative history is exactly the converse. As we have pointed out in our opening brief (at pp. 16–18), Congress wrote Section 117(h) with the express purpose of taxing grants "which are in effect merely payments of a salary during a period while the recipient is on leave from his regular job" (H. Rep. No.

1337, 88d Cong., 2d Sess. 17). There could be no more precise characterization of respondents' situation.[2]

The fact that Section 117(b) expressly deals with only two situations—compensation to part-time teaching or research assistants and the government or foundation grant to a non-degree candidate—does not mean that all other grants are exempted under Section 117(a). Respondents concede as much by their treatment of *Reese* and *Wooddail*. The correct view is that Congress in Section 117(b) dealt with the two particular problems that had arisen prior to 1954 and had proved troublesome to the Treasury. As in so many other instances in the administration of the Internal Revenue laws, the then unforeseen problems were to be resolved through the Treasury's authority (26 U.S.C. 7805(a)) "to prescribe all needful rules and regulations for the enforcement" of the Internal Revenue Code.

The regulations under Section 117, which formed the basis for the instructions given the jury here,

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[2] In addition, Congress said (H. Rep. No. 1337, *supra*, 17) of the amounts being exempted in Section 117(a), "[s]uch grants generally are of small amount and are usually received by individuals who would have little or no tax liability in any case." The grants Westinghouse provided respondents do not fit this description. Respondents Johnson and Peramtz each received $5,670 over nine months, representing an annual rate of about $7,300. Respondent Wolfe received $9,698 over a full year. The grants were received at various times between October 1, 1960 and July 31, 1962. (R. 7-8.) Statistics show that during the three years 1960 through 1962 over 70% of individual income tax returns reported adjusted gross income of less than $7,000 and at least 84% reported an adjusted gross income of less than $9,000. U.S. Treasury Department, Internal Revenue Service, *Statistics of Income for 1960, Individual Income Tax Returns*, Table I, p. 32; U.S. Treasury Department, Internal Revenue

are a direct implementation of the Congressional concern that Section 117 should not exempt from taxation continuing salary payments to employees on leave from their regular jobs. There is neither a logical nor a legal basis for respondents' theory that Congress chose to exempt from tax all compensatory payments to degree candidates unless they were given in return for current services, as in *Reese* or *Woddail*, or fit the exact terms of Section 117(b)(1). Indeed, to exempt respondents' payments, while taxing the relatively modest amounts paid graduate teaching and research assistants as required under Section 117(b)(1) would reintroduce into the tax laws the very sort of inequity that Congress abolished when it limited the amount of exemption that could be claimed by nondegree candidates. (See our opening brief at pp. 12–16.) The Treasury Regulations are a rational and proper interpretation of the Congressional purpose [3] and the Third Circuit erred in refusing to apply them to this case.[4]

Service, *Statistics of Income for 1961, Individual Income Tax Returns*, Table I, p. 32; U.S. Treasury Department, Internal Revenue Service, *Statistics of Income for 1962, Individual Income Tax Returns*, Table I, p. 33.

[3] In their brief on the merits (p. 18), as in their brief in opposition to the petition, respondents seek to support their position on the ground that the Internal Revenue Service has under consideration revisions of the regulations under Section 117. As we pointed out in our reply to the brief in opposition, any substantive changes would allow the exemption on the facts of such cases as *Wells* v. *Commissioner*, 40 T.C. 40, see Rev. Rul. 65–59, 1965–1 Cum. Bull. 67, but not change the position taken in cases such as the present one.

[4] It does not follow from our position (see Respondents' Br. 10, 15) that all scholarships or fellowships would be taxable,

Respectfully submitted.

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or that even all grants from employer to employee would fail to qualify for the exemption of Section 117. This case involves only the narrow problem of characterizing payments given in return for a promise to provide services or some other valuable consideration—a bartered transaction in which *quid pro quo's* are exchanged. Obviously this does not, as respondents would have it (Br. 7–9), encompass every grant given for the support of a scholar or researcher simply because the recipient promises to undertake studies or research. Of course, when the payment goes from employer to employee, a serious question will always arise as to the purpose of the arrangement. But if the money is not contingent on the promise of services—past, present or future—then it should qualify for the exemption.

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